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No. 180

In the Supreme Court of the United States

OCTOBER TERM, 1932

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

R. P. CLARK

ON A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA

BRIEF FOR THE PETITIONER

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OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 11–12) is reported in 19 B. T. A. 859. The opinion of the Court of Appeals of the District of Columbia is reported in 59 F. (2d) 1031. (R. 19.)

JURISDICTION

The judgment of the Court of Appeals was entered April 11, 1932. (R. 22.) Petition for a writ of certiorari was filed June 27, 1932, and granted October 10, 1932. (R. 23.) Jurisdiction is

conferred upon this Court by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Were the losses sustained by respondent in 1921 by reason of his indorsement and payment of certain notes of the Bowers Southern Dredging Company and in 1921 and 1922 from the sale of certain stock of that corporation "net losses resulting from the operation of any trade or business regularly carried on by the taxpayers," within the meaning of Section 204 (a) of the Revenue Act of 1921?

STATUTE AND REGULATIONS INVOLVED

These are set forth in the Appendix, *infra*, pp. 9–11.

STATEMENT

The findings of fact made by the Board of Tax Appeals (R. 7–11) may be summarized as follows:

Bowers Southern Dredging Company (hereinafter referred to as the Bowers Company) was organized in 1899 (R. 8), and between that time and September 1, 1922 (R. 10), was engaged in dredging and other river, harbor, and jetty works (R. 8). At the time of its organization respondent became a stockholder (R. 8) and associated with the company (R. 8). In 1905 he became its president, and remained in that capacity as long as the company continued to operate. As president and majority stockholder he was the active direct-

ing head of the corporation, devoting all of his time to its operations. (R. 8.)

At the beginning of the war in 1917 the company began to experience financial difficulties. This finally resulted in its business being placed in the hands of a creditors' committee, under which it was operated in 1921 (R. 9) and until September 1, 1922 (R. 8), when the Clark Dredging Company, organized by respondent, took over its assets and liabilities (R. 10). During the time that the business of the Bowers Company was in the hands of the creditors' committee respondent served as managing operator of the company for that committee, and continued as such until September 1, 1922. (R. 8.)

The Bowers Company was unable to borrow money from banks without the individual indorsement of respondent, and therefore at various times, in order to protect his investment in the stock of the company, the respondent indorsed its notes. (R. 9.) In 1921 respondent, as such indorser, was called upon to, and did, pay $68,000, for which he claimed and was allowed a deduction in his income-tax return for that year. (R. 9.)

In 1922 the respondent, being desirous of having some one with financial resources associated with the business of the Bowers Company, sold 1,000 shares of his stock in that company (which had cost him $100,000) to George H. Nolan for $7,500, thus sustaining a loss of $92,500, for which he claimed

and was allowed a deduction in his 1922 return. (R. 9–10.)

During the years 1921 and 1922 respondent also owned, as investments, stock in a number of corporations, and in addition to his activities for and on behalf of the Bowers Company he was a member of and took an active advisory interest in three partnerships engaged in the business of dredging, river and harbor work, and jetty building, mostly in connection with the work of the Bowers Company. (R. 8.)

Respondent's income for 1921 and 1922 was not sufficient to absorb the losses sustained in those years and allowed as deductions by the Commissioner of Internal Revenue, as stated above, with the result that there were unabsorbed balances of $17,768.51 for the year 1921 (R. 9) and $4,985.10 for the year 1922 (R. 10). In his return for 1923 respondent claimed the right to carry these unabsorbed losses forward as "net losses resulting from the operation of any trade or business regularly carried on by the taxpayer," deductible in computing the net income for that year under Section 204 (a) of the Revenue Act of 1921 (*infra*, p. 9). The Commissioner of Internal Revenue disallowed the claim and determined a deficiency accordingly. (R. 11.)

The Board of Tax Appeals held that the evidence did not establish that respondent was engaged in the business of indorsing or guaranteeing notes,

and hence the losses aggregating $68,000 sustained in 1921 by reason of the indorsement and payment of the Bowers Company notes resulted from isolated transactions and therefore "did not result from the operation of a trade or business regularly carried on by the petitioner." (R. 11–12.)

As to the $92,500 loss sustained by respondent upon the sale of Bowers Company stock in 1922, the Board held that the ownership of stock in several corporations as investments, or the sale of some of such stock, did not constitute "a business or trade regularly carried on * * *"; that respondent was neither in the investment business nor the business of dealing in securities, and therefore the loss resulting from the sale of the Bowers Company stock constituted a loss arising from an occasional or isolated transaction "and not from the operation of a business regularly carried on." Accordingly the action of the Commissioner was sustained. (R. 12.)

Upon stipulation (R. 13) the case was taken to the Court of Appeals of the District of Columbia for review (R. 13–17). That court, in reversing the decision of the Board of Tax Appeals (R. 22), held that respondent "was engaged in regularly carrying on the business of dredging, operated by a corporation of which appellant (respondent) was principal owner and active directing head, and to which he devoted all of his time and energies," and that the indorsement and payment of the cor-

porate notes and the selling of the corporate stock was a part of that business (R. 21). This Court granted the Commissioner's petition for a writ of certiorari.

SPECIFICATION OF ERRORS TO BE URGED

The court below erred—

1. In holding that the losses sustained by respondent were "net losses resulting from the operation of any trade or business regularly carried on by the taxpayer" within the meaning of Section 204 (a) of the Revenue Act of 1921.

2. In reversing the decision of the Board of Tax Appeals.

ARGUMENT

The court below held that respondent "was engaged in *regularly carrying on the business of dredging, operated by a corporation* of which appellant (respondent) was principal owner and active directing head, and to which he devoted all of his time and energies" (italics ours), and that the indorsement and payment of the corporate notes and the selling of the corporate stock was a part of that business. (R. 21.)

Thus the court disregarded the corporate entity and held that the business of the Bowers Company was respondent's business. It will be seen that this is the same issue raised in *Hubert Dalton and Florence W. Dalton* v. *Frank C. Bowers, as Executor of the Last Will and Testament of Frank K.*

Bowers, Etc., No. 52, October Term, 1932, now pending in this Court. In its brief in that case the Government argues that even where an individual owns all of the stock of a corporation (as Dalton did), a loss which, if incurred in any business regularly carried on, is incurred in the business of the corporation and not in that of the "taxpayer," can not be used to make up a "net loss." The settled principles which dispose of such a case are discussed at length in that brief. In the instant case Clark owned but a majority of the stock of the corporation. (R. 8.) Others were interested in it and therefore under no circumstances could the corporation be considered as the "alter ego" of Clark. As president and active directing head of the corporation (R. 8) Clark was the agent of the corporation and he indirectly represented the stockholders. His acts were the corporation's acts. The corporation's acts were not his. He was neither in the business of lending money nor selling stock. Accordingly his losses were the result of mere isolated transactions, which under authorities cited in our brief in the *Dalton* case were not attributable to any business regularly carried on by him. The only possible theory which would permit deduction involves a disregard of the corporate entity, and, for reasons stated in the respondent's brief in the *Dalton* case, the entity may not be disregarded.

In view of the close similarity of the two cases it is considered unnecessary to reiterate at length

what has been said in our brief in the *Dalton* case, and therefore we ask that the argument therein be considered as our argument here.

CONCLUSION

The decision of the court below is erroneous and should be reversed.

Respectfully submitted.

THOMAS D. THACHER,
Solicitor General.
G. A. YOUNGQUIST,
Assistant Attorney General.
WHITNEY NORTH SEYMOUR,
SEWALL KEY,
JOHN H. MCEVERS,
Special Assistants to the Attorney General.

OCTOBER, 1932.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1921, c. 136, 42 Stat. 227, 231:

SEC. 204. (a) That as used in this section the term "net loss" means only net losses resulting from the operation of any trade or business regularly carried on by the taxpayer (including losses sustained from the sale or other disposition of real estate, machinery, and other capital assets, used in the conduct of such trade or business); and when so resulting means the excess of the deductions allowed by section 214 or 234, as the case may be, over the sum of the following: (1) the gross income of the taxpayer for the taxable year, (2) the amount by which the interest received free from taxation under this title exceeds so much of the interest paid or accrued within the taxable year on indebtedness as is not permitted to be deducted by paragraph (2) of subdivision (a) of section 214 or by paragraph (2) of subdivision (a) of section 234, (3) the amount by which the deductible losses not sustained in such trade or business exceed the taxable gains or profits not derived from such trade or business, (4) amounts received as dividends and allowed as a deduction under paragraph (6) of subdivision (a) of section 234, and (5) so much of the depletion deduction allowed with respect to any mine, oil or gas well as is based upon discovery value in lieu of cost.

(b) If for any taxable year beginning after December 31, 1920, it appears upon the production of evidence satisfactory to the

Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be deducted from the net income of the taxpayer for the succeeding taxable year; and if such net loss is in excess of the net income for such succeeding taxable year, the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year; the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

* * * * *

Treasury Department Regulations 62:

ART. 1601. *Net losses, definition and computation.*—The term "net loss" as used in the statute means only a net loss resulting from the operation during the taxable year of any trade or business regularly carried on by the taxpayer. Included therein are losses from the sale or other disposition of real estate, machinery, and other capital assets used in the conduct of such trade or business. In order to be entitled to claim an allowance for a "net loss" the taxpayer must have suffered an actual net loss in a trade or business during the taxable year. The amount properly allowable may be neither the loss reflected upon the return filed for the purpose of the income tax nor the net loss shown by the taxpayer's profit and loss account, but is to be computed according to the statute, as follows:

(1) In the case of an individual, it is the amount by which the deductions allowed under section 214, excluding:

(a) the amount by which the deductible losses not sustained in such trade or busi-

ness exceed the taxable gain or profits not derived from such trade or business;

* * * * *

(c) the amount of deductions allowed under section 214 not connected with the trade or business,

exceeds the sum of the following:

(a) the gross income of the taxpayer for the taxable year as computed under section 213; and

(b) the amount by which the interest received free from taxation under the provisions of the Act exceeds so much of the interest paid or accrued within the taxable year on indebtedness as is not allowed as a deduction under section 214 (a) (2).

* * * * *

In computing statutory "net loss" the following restrictions are to be noted:

(1) Interest received by the taxpayer on obligations or securities, the interest from which is exempted from taxation must be included in income, but this amount may first be reduced by the amount of any interest paid by the taxpayer on money used to purchase or carry such obligations or securities.

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U. S. GOVERNMENT PRINTING OFFICE: 1942